

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0752

WITHHOLDING TAX

FOR TAX PERIODS: 1995-1997

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1. Withholding Tax: Employee v. Independent Contractor

Authority: IC 6-3-4-8 (a,b,g), IC 6-8.1-5-1 (b), Longmire v. Indiana Department of State Revenue, 638 N.E.2d 894, 897, Indiana Tax Court, 1994.

The taxpayer protests the classification of service providers as employees.

2. Withholding Tax: Safe Haven

Authority: 26 U.S.C.A. 530

The taxpayer requests safe haven treatment.

3. Tax Administration: Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2(b).

The taxpayer protests the imposition of the penalty.

Statement of Facts

The taxpayer is a general contractor whose business activity consists of commercial and residential contracts. The taxpayer performs both lump sum and time and material jobs. After a routine audit, the taxpayer was assessed additional withholding tax, penalty and

interest. Taxpayer protested the assessment. Further facts will be provided as necessary.

1. Withholding Tax:. Employee v. Independent Contractor

Discussion

A business which is required under federal law to withhold, collect and remit withholding tax to the Internal Revenue Service on wages paid to its employees must also deduct, withhold and remit Indiana withholding tax to the Indiana Department of Revenue on wages paid to its employees. IC 6-3-4-8 (a). Failure to withhold tax on wages paid to the business' employees causes the employer to be liable for the withholding tax. IC 6-3-4-8 (g). Businesses are not required to withhold, collect and remit withholding on fees paid to independent contractors. If an employer does not collect and remit withholding tax for employees, the employee withholding tax is assessed against the business. IC 6-8.1-5-1 (b). Assessments by the Indiana Department of Revenue are presumed to be correct and the taxpayer bears the burden of proof that the assessment is incorrect. IC 6-8.1-5-1 (b).

Determining whether an individual worker is an employee or independent contractor necessitates examination of the relationship between the worker and the business. Behavioral and financial controls are the crucial factors in determining whether an employee relationship exists. An employment relationship exists when "the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." Longmire v. Indiana Department of State Revenue, 638 N.E.2d 894, 897, Indiana Tax Court, 1994.

The auditor determined that most of the individual workers on the taxpayer's projects were employees and assessed withholding tax against the taxpayer on their wages. The auditor's determination of employee status was based on several factors. The taxpayer had registered to collect and remit withholding tax. Further the taxpayer did not prepare 1099 Miscellaneous Income Statements for the individual workers each year. Rather, the taxpayer produced the 1099 Miscellaneous Income Statements at the time of the audit. Many of the statements were not completely filled out. A search of the Indiana Department of Revenue records indicated that the majority of the individual workers did not file individual Indiana income tax returns. The taxpayer was unable to produce contracts, invoices or billings which would indicate an independent contractor status.

The taxpayer contends that all of the individual workers were independent contractors. The taxpayer produced statements from several individual workers concerning their relationships with the taxpayer. Although the statements were not identical, each of these statements indicated that the individual worker or subcontractor was an independent contractor rather than employee. The statements included several items such as the individual workers considered themselves independent contractors, provided their own insurance, reported and paid income taxes on the fees received, chose their own hours, provided their own tools and bill and receive payment by the job rather than the hour. These statements were made after the fact and were not notarized or made

under penalties of perjury. These self serving statements do not meet the statutory standard or a preponderance of the evidence. The taxpayer has not met its burden of proof that the individual workers were independent contractors rather than employees. The taxpayer's protest to these assessments is denied.

Finding

The taxpayer's protest is denied.

2. Withholding Tax: Safe Haven

Discussion

The taxpayer contends that it qualifies for safe haven treatment for the individual workers who have been found to be employees and subject to the withholding tax. Safe haven treatment is offered pursuant to 26 U.S.C.A. 530. If a taxpayer qualifies for safe haven treatment, employees can be treated as independent contractors and withholding tax is not assessed against the employer. Safe haven treatment is available if employers meet three requirements. First the employer must have relied on the advice of a tax professional that the individual workers and subcontractors were independent contractors. In this case, the taxpayer submitted a statement from its former accountant that satisfied this requirement. Secondly, the taxpayer must have issued 1099 Miscellaneous Income Statements. The taxpayer did not sustain his burden of proving that it issued these statements at the proper time since they were not originally available for the auditor. Further, many of the statements the taxpayer produced were incomplete. The taxpayer did not meet this requirement. Finally the taxpayer must treat all individual workers and subcontractors in the same manner. The taxpayer did not sustain its burden of proof that it treated all in the same manner. The auditor found that three of the workers were actually independent contractors. The remainder, as discussed in the previous issue, were employees. Since the taxpayer did not meet all three of the requirements, it does not qualify for safe haven status.

Finding

Taxpayer's protest is denied.

3. Tax Administration: Penalty

Discussion

The taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations

is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence.

The taxpayer did not maintain good records and did not exhibit diligence in the issuance of the 1099 Miscellaneous Income Statements. This constitutes negligence. Taxpayer's final point of protest is denied.

Finding

Taxpayer's protest is denied.

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